

**From:** phamilton@northcountycu.com  
**Sent:** Friday, April 03, 2009 6:45 PM  
**To:** \_Regulatory Comments; league@ccul.org  
**Subject:** Final Comments on NCUA ANPR on Corporate Credit Union System Strategy

From: Pat Hamilton  
Credit Union: North County CU  
Message:  
April 6, 2009

Ms. Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

RE: Comments on the Corporate Credit Union System Strategy

Dear Ms. Rupp:

On behalf of North County Credit Union, I appreciate the opportunity to comment on the NCUA Board's recent actions designed to stabilize the corporate credit union system. The program, as initially outlined in NCUA Letter to Credit Unions No. 09-CU-02, and as further reflected in NCUA Letter to Credit Unions No. 09-CU-06, included three primary objectives regarding the corporate system: 1) maintaining liquidity; 2) strengthening capital; and 3) evaluating the existing structure of the corporate system via an Advanced Notice of Proposed Rulemaking (ANPR). My comments will address the actions the Board has taken towards accomplishing these objectives, and some of the effects it will have on our credit union.

#### Maintaining Liquidity and Strengthening Capital

North County Credit Union is concerned that the Board's strategy, as crafted and implemented to date, does not fully take into account the serious repercussions to our credit union, and the effect it will have on our members. This concern has been deepened by NCUA's unexpected actions on March 20, 2009, involving U.S. Central FCU and Western Corporate FCU (WesCorp), which has caused our credit union to have even greater losses than planned. Further, we believe that the strategy is too narrowly-focused and inflexible in its approach in that it fails to take advantage of several other options and tools available to the Agency that could reduce the costs and impact of the program. Our fear is that unless alternative methods and tools are used to soften the staggering financial blow of NCUA's actions, our small credit union that has spent over 55 years serving our very "techie" membership and our community may never fully recover from its impact. As a result, we believe there is a real risk that the community confidence we have spent years in building will erode, and cause a public embarrassment to members in our community. However, we are encouraged and cautiously optimistic that the Board's action on March 26, 2009, to ask Congress to form a Corporate Credit Union Stabilization Fund takes an important step towards addressing this concern. By spreading the cost of the stabilization action over as much as seven years, we may be able to work through this truly devastating economic downturn.

We are a small conservative credit union, dedicated to lending to our members and offering them the many services that they need to be financially healthy. We do not have any "fancy" investments; in fact our investment portfolio consists of mostly insured certificates of

deposit in other financial institutions. We consider ourselves lenders, and this is a mission we take seriously and in a conservative manner. We try to keep our loan to share ratio between 85% and 90%.

#### Impact on North County Credit Union

As a result of the 69 percent NCUSIF write off, the accompanying premium assessment to return the NCUSIF capitalization ratio to 1.30 percent, and the write-off of PIC and MCA shares at WesCorp, we fear that our capital will fall into the 6% range. While we are working hard to prevent that, the only realistic option that we have available at this time is to somehow reduce our assets, and we may have to find a way to get our members to move some of their shares to other financial institutions. It is not as if we have a long time to take these hits and rebuild our capital position. Ultimately, this will cause us to pull back from providing loans and other financial products and services to our members when they need them most. I and our Executive Vice President have been serving our members in this credit union for over 30 years, both having come to NCCU in 1978, we know many of our members and they trust us to watch over their money and make them loans when they need them. During this trying time we have received many questions and always the statement that they are glad to see us watching over their credit union. It is very sad, after all these years, to think that we will have to send some of them elsewhere for services. We have many accounts designated as FOG accounts, "friends of Gary", who depend on him to always help them and give them sound advice. Some examples of the problems we are facing are:

- Fear of long-term interest rate risk
- Fear of falling under the magical 7% PCA threshold
- Fear of losing some of our best members because we must cut back our services
- Fear of not being able to help our members during a time of need. For example, we are located in the community that was in the middle of the 2007 firestorm in Southern California. Our community lost many homes and over 30 of our members lost everything running from the flames. We have helped the people who needed it by giving interest free loans up to \$5,000.00 to those who qualify for credit. That is what a credit union does, that is our mission. We have not taken that offer off the table, and although most of our members had enough insurance, we did help some days after the fire, and are now seeing a few requests due to the fact they are trying to finish up their homes, and have run short on funds for carpeting, or some other item. Of course this is the first "service" we will stop offering in order to meet the needs of the corporate and NCUSIF fund. It may not sound like much, but be glad you were not in our lobby the first day we were allowed in after the fire to see the depth of our members despair, as many sobbed in the lobby.

I have to ask if we, a small credit union, are considered to be expendable. Perhaps in the panic that has beset our economy some think we are, but I maintain that credit unions such as ours are still the backbone of the Credit Union movement and that these times will pass as have many others during my career.

#### Immediate Actions NCUA Could Take To Preserve our Credit Union

First, we urge NCUA to consider permitting credit unions to charge the insurance costs of the stabilization plan directly to Undivided Earnings rather than reflecting it on the Income Statement. We understand that NCUA has stated that Generally Accepted Accounting Principles (GAAP) dictates that credit unions following GAAP book the premium as an expense in the reporting period incurred, and that the Federal Credit Union Act (Act) requires credit unions to file their Call Reports in accordance with GAAP. However, we would like to point out that §202(a)(6)(C)(ii) of the Act further states:

Board determination.—If the Board determines that the application of any generally accepted accounting principle to any insured credit union is not appropriate, the Board may prescribe an accounting principle for application to the credit union that is no less stringent than generally accepted accounting principles. (emphasis added for discussion)

Clearly, the Act permits NCUA to substitute its own accounting principles for GAAP when necessary. As the Agency states—accurately—in Letter to Credit Unions No. 09-CU-02: “Current financial market conditions...are like nothing experienced since the Great Depression.” Given this stark truth and the effect such conditions will have on credit unions such as ours—as well as actions such as the call to temporarily suspend mark-to-market accounting—we submit to the Board that dire economic times require bold action. Indeed, while some at the Agency may view permitting the expense to be booked in this manner to be overly zealous, we are of the opinion that it falls soundly and reasonably within a fair reading of §202(a)(6)(C)(ii).

Namely, we believe that the application of GAAP in this situation would not be “appropriate,” since such an application would lead to a variety of negative consequences (e.g., previously unseen levels of negative earnings having a damaging effect on the confidence that members and the public have in the safety and soundness of credit unions) that could ultimately involve risk to the NCUSIF. Further, if the application of GAAP is deemed not appropriate, we believe that permitting the charging of these costs to Undivided Earnings would be “no less stringent” than GAAP, as the ultimate effect on credit unions’ balance sheets would be the same—namely, net worth would be reduced on the balance sheet by the same amount that it would have been had the charge been expensed through the income statement. In other words, the financial statements (certainly the balance sheet and footnotes) would still present accurately and fairly the overall financial condition of the credit union. Also, such a deviation from GAAP would not compromise the safety and soundness of the Fund. Therefore, we suggest NCUA seriously consider this avenue, and challenge the Agency to provide its reasoning as to why this authority granted to it by the Act is being left unutilized during such a critical time. While we are aware that this will still affect our credit union in a negative way, we believe it will more fairly represent what is happening in the economy to our members.

Next, we believe that the NCUA should utilize its regulatory authority to redefine the definition of “total assets” under §702.2(g) of the Prompt Corrective Action rule to exclude guaranteed or low/no-risk assets from net worth ratio calculations. This action would provide immediate relief in the following ways:

- It would allow our credit union, which has \$6,000.00 in laddered insured certificates to hold our capital position.
- It would not affect liquidity since these investments can be redeemed with only an interest penalty if liquidity is needed. In the past we have used this method when we deemed it less expensive to pull in a certificate investment than borrow on our line of credit. As all financial institutions do we watch our liquidity closely.
- It would negate the necessity of driving member’s funds and accounts out of the credit union to low our assets, thus allowing us to continue to serve our members.

We applaud the NCUA for issuing guidance to examiners which includes instructions to recognize and allow for temporary reductions in ROA and net worth that result from credit union participation in the CU SIP program, and for recently taking action to amend its rule on the assessment of the federal credit union operating fee to exclude investments made under the CU SIP and CU HARP programs from the calculation of total assets. However, we believe it would provide more uniformity and reliability to formally make this redefinition via an amendment to the PCA regulation. If NCUA does take this reasonable and much needed step, we recommend that the following assets be excluded from “total assets” for the calculation of net worth:

- Cash

- Overnight investments in corporate credit unions
- CU SIP deposits in corporate
- Corporate CU CDs
- Insured institutional certificates of deposit
- Guaranteed student loans
- Share secured loans
- Guaranteed portion of SBA loans
- Shares and loans guaranteed by the government
- Other government/recourse loans
- Accrued interest of non-risk investments
- Loans purchased from liquidating credit unions
- Assets held with options to sell to government
- Loans under Corporate CU Loan Guarantee Program
- GNMA/FNMA/FHLMC (GSE) securities/bonds
- U.S. Treasuries
- Furniture, fixtures, and equipment
- Land and buildings

Our calculations indicate that such a redefinition of “total assets” can positively impact our credit unions’ net worth ratios. As of December 31, 2008, our net worth ratio was 8.17%. Using a risk-weighted system we would be in the area of 9.92% which would allow us to absorb the coming write down and loss of WesCorp capital, and still hold our 7% capital. In other words it would give us a chance to survive and even grow in the near future. Again, let me state that we do not have any risky investments in our portfolio. In our opinion, no/low-risk assets represent less risk to a credit union and should not require the same level of reserves as riskier assets. In the absence of a risk-weighted system for calculating credit union net worth (proposed and supported by NCUA in 2005) credit unions are unfairly and misleadingly penalized for holding assets that are of lower risk. Consumers, in short, are not being provided with an apples-to-apples comparison when a credit union’s net worth is calculated under NCUA’s PCA framework and current definition of “total assets”. Indeed, to ignore this option is to invite unnecessary instability into the credit union system when NCUA’s top priority should be to take steps towards system stabilization.

#### Tools Available to NCUA Through Congress

In addition to the immediate steps described above, we support the efforts of the Leagues, CUNA, NAFCU, and other state leagues that are continuing to work with Congress to obtain the following tools to help NCUA address current liquidity and capital issues:

- TARP or other government funds as a backstop to NCUSIF - Credit unions have been working with members of Congress to urge the Treasury to set aside at least \$20 billion of TARP funds to be accessed should corporate or natural person credit union losses covered by the NCUSIF exceed \$500 million. By allowing NCUA to reduce the current cost to credit unions of the corporate stabilization plan, this action would greatly mitigate the negative impact on credit unions’ ROA and net worth and would bolster both credit union system confidence and public confidence.
- Corporate access to the Central Liquidity Facility (CLF) - As recommended in the January 2009 report from PricewaterhouseCoopers LLC to the NCUA Board, the CLF should be used to infuse liquidity and capital into the corporates. A change to the Federal Credit Union Act would expand authority of the CLF beyond its current authority to make liquidity loans only to natural person credit unions to permit direct investment in corporates.
- Replenishment of the NCUSIF over multiple years - FDIC is currently permitted five years to replenish their insurance fund. Section 2 of H.R. 786 (which makes permanent the \$250,000 deposit insurance coverage for federally-insured financial institutions) would extend this period of time to eight years. In the interest of greater regulatory coordination

within the financial services sector, we believe the replenishment period for credit unions should mirror that of banks, and are pursuing an amendment to this legislation to provide a similar restoration period for the NCUSIF.

- Risk-based net worth standards – Efforts to modernize the PCA system may also include urging Congress to consider the removal of all of the PCA stipulations from the statute and leave it to regulatory determination, similar to the system under which the banking industry operates. This would provide for greater flexibility and responsiveness, especially during times of crisis. Credit unions such as NCCU, which have proven to be less risky financial intermediaries than banks and thrifts, should be subject to a PCA framework that provides, at minimum, as much flexibility as the FDIC, the OTS, and the OCC utilize for bank PCA standards.

- o NCCU along with the Leagues also encourage the NCUA Board to support changes to the definition of net worth that would allow government assistance in the form of loans to credit unions to be included in a credit unions net worth ratio. Such loans, in the form of “Section 208” assistance, were used effectively in the 1980’s to help a number of credit unions through a severe economic crisis. These credit unions are now healthy, and are providing valuable services to hundreds of thousands of members. The loans that were used to help these credit unions were repaid, with interest.

- Credit union access to alternative capital – In order to effectively compete, to have a sufficient financial base to effectively serve their members, and to adjust to fluctuating economic conditions, credit unions must have the ability to build additional capital. Structured properly, giving credit unions this ability will provide an additional buffer to the NCUSIF, and make the fund stronger.

We urge NCUA, to work with The Leagues and natural person credit unions to actively support the ongoing efforts to secure these tools for NCUA, and further recommend that the Agency assertively pursue the recently announced Treasury initiative designed to deal with troubled assets (i.e, the ‘Public-Private Investment Program’).

#### Other Possible NCUA Actions in View of Credit Union Ownership Interests

As a small credit union, without very much experience in dealing with the problem securities, we would still like to comment regarding NCUA’s use of and reliance on Pacific Investment Management Company (PIMCO) and its analysis of the residential mortgage backed securities (RMBS) held by corporates. Before committing almost \$6 billion to replenish the share insurance fund, not to mention impairments of credit union capital deposits in corporate credit unions, credit union owners of WesCorp and US Central deserve very detailed information on the assumptions, methodology, and results of the PIMCO study in order to better understand the calculation of the cost estimates, and to determine whether the agency’s cost estimates of the losses for the corporates are reasonable and justified. To date NCUA has provided credit unions little information about the PIMCO report, and absolutely no details from it. Further, we are gravely concerned about the apparent conflict of interest between PIMCO's role as analyst of corporates' portfolios and their publicly stated intention to purchase legacy/toxic assets under the Treasury’s Public-Private Investment Program. If true, we believe that NCUA should lead the Agency to reevaluate PIMCO’s current loss estimates for the corporates, as well as discontinue any further reliance on the company’s analysis regarding this issue. At that point, the NCUA Board should work on devising a plan for credit unions to pay for the actual losses that may result from corporate investments as they occur, rather than requiring credit unions to pay up-front based on a theoretical estimate of the costs.

Finally, we would like to see some or all of our member equity in WesCorp restored. Therefore we propose that the Agency determine a regulatory or legislative solution for this matter. Credit union members of the corporate deserve to have a degree of membership/ownership interest, and should have provided to them by NCUA having a planned path to WesCorp’s recovery and return to member ownership and control. AIG, BAC, Citigroup and others were technically insolvent and bailed out by the government, yet their shareholders were left with

some, albeit significantly impaired, equity. We believe that a similar type of solution for credit unions should be explored. Such a move would go a long way towards restoring our sense of ownership, responsibility, and having a voice in WesCorp's future.

On an important related note: while we of course have concerns about the steps taken by NCUA concerning the corporate stabilization actions to date, we certainly have faith that NCUA's intentions are good, and are aimed at saving the credit union industry. While we may "agree to disagree" on exactly how this should be accomplished, we will continue to support the NCUA and the credit union movement.

### The Role of Corporates

NCCU believes that corporates serve a vital role for credit unions. By serving as a central point for credit union investment and payment system services and aggregation, they provide many services that typically would be economically available only to the largest financial institutions (e.g., share draft processing, wire transfers, ACH services, cash orders, etc.). For a small credit union such as ours, the line of credit provided by our Corporate, allows us to continue lending and running our business even when liquidity is tight. We believe it would be difficult for us to obtain a line of credit in the market place due to our size. By managing liquidity within the credit union industry, corporates are able to effectively and efficiently move excess liquidity to the areas of greatest need. In addition, they provide the wherewithal to help credit unions manage risk, and are uniquely positioned to facilitate participation lending. Operational efficiencies and cost considerations prohibit many credit unions from obtaining these services directly from the Federal Reserve.

In the past we have had to rely on other banks and financial institutions that WesCorp now provides for us. Believe me when I say that it can be a nightmare, especially in our case when Southwest Bank sold to Security Pacific. The loss of ATM accounts, and other conversion problems caused our members and staff great angst. Having WesCorp to rely on, has removed this problem.

### Key Areas of Disagreement

Our disagreement with the ANPR includes NCUA's contemplation to establish separate charters for payment system services and investments, as well as a return to defined fields of membership. We believe such a move would be anti-competitive and would hamstring the viability of the corporate system, likely leading to future problems requiring intervention by NCUA and/or natural person credit unions. Furthermore, not every corporate offers a full array of services (e.g., item-processing for imaged items). Restricting corporate usage to geographic fields of membership would unfairly and unsafely restrict credit unions from accessing critical corporate services. Along the same lines, we feel that a requirement that an "outside director" be from entirely outside the credit union industry would be potentially damaging, and could serve to weaken the unique nature and philosophy of credit unions (and, frankly, we believe that such a requirement would not have prevented current circumstances). As an example, we were talking with EastCorp about a product they were offering, remote deposit, at a very competitive price. Being a one branch credit union, this product brings us one step closer to being able to serve our field of membership. Having choices is always necessary.

### Areas Where Improvements are Needed

Of course there is room for greater efficiencies, more effective risk management in the system, and governance enhancements.

Greater Efficiencies. We believe that corporate consolidation would be beneficial to the system, and that NCUA should be more open, responsive, and supportive of such consolidation by removing unreasonable impediments and/or resistance to corporate credit union mergers. We

realize that each tier of the corporate network takes its own share of income, adds another layer of cost, each has its own capital requirements, all of which reduces efficiency and effectiveness.

**More Effective Risk Management.** Recent events indicate that corporates require a larger capital cushion, a greater diversification of investment to include more restrictions on concentration risk, and more—or at least better—risk management tools. In addition, to provide an even more robust “firewall” between corporate credit union risk and natural person credit union safety, NCUA might consider the creation of a separate insurance fund or separate insurance “system” for corporate credit unions in the future. As the Federal Reserve and Treasury contemplate measures for reducing systemic risk, it will be important to recognize the systemically important role the corporate system plays in the nation’s “financial plumbing.” Ultimately, 90 million credit union members rely on the corporate system to provide trading, payments, clearing, and settlement services for their local credit unions. NCUA’s aim should be to assure that the credit union system as a whole is better able to withstand future shocks.

**Enhanced Governance.** Finally, term limits for directors would be reasonable, as would minimum standards for experience, knowledge, and training.

To summarize: we believe that while the corporate system is in need of some key adjustments, it is not broken. External factors are what caused the current crisis, not the corporate system structure. Going forward, our credit union would like to be reassured that NCUA will maintain an ongoing evaluation as to the possible need to continue the corporate deposit guarantee past 2010, and that the Agency is prepared to address the concurrent maturities of CU SIP investments.

In closing, we would like to say that while the situation we find ourselves in today may seem dire and very scary, it will improve. I have been here before and it always amazes me how times that seem dire always “fix” themselves with time. I feel that the new accounting rules, the ability of holding securities to maturity, and market recoveries will resolve many of the problems we face today. In the early 1990’s we had a group of CMOs in our portfolio. The uproar from examiners was very harsh and loud, perhaps why we now do not have any toxic securities, however, we held them to maturity, and did not lose any money in the end.

As an old credit union person, I ask that each of us takes a deep breath, steps back from the brink, and seriously considers the future of credit unions. I believe that we are small but mighty in the financial services market, and the good that we do for our members is well known. We as a small credit union are the backbone of the industry. We know our members, we loan to our members, and we care about our members, their families, their children, and their future. I would hate to end my career seeing credit unions like ours cease to exist when the recovery comes, and it will come. I also ask that all parties keep in mind that it is our members’ money that is being spent at all times. Capital does not belong to us, it is our members. I am still quite struck by the statements that not one penny of tax money is now being used. The last time I checked, our members pay taxes. I believe we must always tread carefully when using members funds.

It is my hope that when the dust clears and the economy starts to recover, NCUA, Corporates, and Natural Person Credit Unions can proudly say that we stood together, made a plan, and kept our members money safe and secure.

If you have any questions concerning this matter or our credit union please contact me at (858)487-1880, ext. 3123 or [phamilton@northcountycu.com](mailto:phamilton@northcountycu.com).

Sincerely,

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